KPMG

Financial Reporting Matters

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AUDIT

In this inaugural issue of *Financial Reporting Matters*, we highlight the standard on non–current assets held for sale and significant changes in accounting for business combinations, including intangibles and impairment.

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The Council on Corporate Governance and Disclosure (CCDG) issued the following **four new FRS** in July 2004:

- FRS 102 *Share-based Payment* to be effective for annual periods beginning on or after 1 January 2005 for listed companies and 1 January 2006 for all other companies
- FRS 103 *Business Combinations* to be effective for annual periods beginning on or after 1 July 2004
- FRS 104 *Insurance Contracts* to be effective for annual periods beginning on or after 1 January 2005
- FRS 105 *Non-current Assets Held for Sale and Discontinued Operations* to be effective for annual periods beginning on or after 1 January 2005

CCDG also announced the revision to the standard on financial instruments on *Fair Value Hedge for a Portfolio Hedge of Interest Rate Risk.*

As a consequence of the requirements in FRS 103, the standards on intangible assets (FRS 38) and impairment of assets (FRS 36) were revised. These revised standards, which affect accounting for intangibles and impairment outside of business combinations, should be implemented at the same time as FRS 103.

To date, CCDG has issued all the equivalent international standards or exposure drafts, except for the standard on investment properties.

About Financial Reporting Matters

Financial Reporting Matters is a new bi–monthly newsletter that aims to keep you updated on financial reporting developments in Singapore. It discusses the implications of changes in financial reporting standards, legislation or SGX rules affecting company reporting.

As Singapore standards are closely aligned to International Financial Reporting Standards (IFRS), KPMG believes that the activities of the International Accounting Standards Board (IASB) are of interest. The latest publications of KPMG's international IFR Group will be enclosed in every issue of *Financial Reporting Matters*.

Accounting for acquisitions

FRS 103 *Business Combinations*

Implementation dates

FRS 103 is Singapore's adoption of the equivalent international accounting standard, IFRS 3. There are differences in the effective date of implementation.

FRS 103 is effective for annual periods beginning on or after 1 July 2004 and early adoption is possible provided certain stringent conditions are met. IFRS 3 is effective for business combinations for which the agreement date is on or after 31 March 2004. Early adoption is also possible under the same stringent conditions.

Transitional provisions relating to FRS 103, the revised FRS 36 and FRS 38 are discussed in greater detail on page 9.

Objective, scope and definitions

FRS 103 applies when an entity combines with one or more other entities or businesses.

FRS 103 introduces the following important definitions:

- **Business combination** – the bringing together of separate entities or businesses into one reporting entity.
- **Business** – an integrated set of activities and assets conducted and managed for the purpose of providing: (i) a return to investors, or (ii) lower costs or other economic benefits directly and proportionately to policyholders or participants. A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.

  It is important to distinguish between a transaction that is a purchase of assets (where FRS 103 does not apply), and one in which it is a purchase of business (where FRS 103 applies). A business does not have to be a separate legal entity.
- **Business combination** involving entities or businesses under common control – A business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the combination, and that control is not transitory. These transactions are excluded from the scope of FRS 103.

Merger accounting prohibited

All business combinations within the scope of FRS 103 must now be accounted for using the purchase method. The uniting–of–interests method that was applicable in limited circumstances in FRS 22 *Business Combinations* is no longer allowed under FRS 103.

The "as–if–pooling" method commonly applied to account for entities under common control continues to be excluded from the scope of FRS 103.

Identifying the acquirer

In instances where it may be difficult to identify an acquirer, FRS 103 provides the following as indicators to assist in identifying an acquirer:

- when the fair values of the combining entities are significantly different, the entity with the higher fair value is usually the acquirer;
- when the cost of the acquisition is paid in cash or other assets, the entity paying cash or giving up the other assets is usually the acquirer; and
- the entity that is able to dominate the selection of the management team of the resulting combined entity is usually the acquirer.

The identification of the acquirer could result in the legal parent company being the acquiree (subsidiary) for accounting purposes. Such an acquisition should be accounted for as a reverse acquisition.

Cost of a business combination

The cost of the business combination is the aggregate of fair value, at the date of exchange, of assets given, liabilities incurred and equity instruments issued by the acquirer plus any cost directly attributable to the business combination. If the business combination is achieved in stages, the date of exchange is the date of each exchange transaction. If the business combination agreement provides for contingent consideration, the amount of the adjustment is included in the initial cost of the business combination if the adjustment is probable and can be measured reliably. Otherwise, it is treated as an adjustment to the cost of the business combination when it becomes probable and the amount can be measured reliably.

Allocating the cost of a business combination to assets acquired and liabilities assumed

At the date of acquisition, the acquirer recognises the acquiree's identifiable assets, liabilities and *contingent liabilities* at fair value. However, there is an exemption for non–current assets classified as held for sale under FRS 105, which are recognised at fair value less costs to sell. If the acquirer does not obtain all of the ownership interests in the acquiree, a portion of the fair value is assigned to minority interest. An acquirer can no longer measure minority interest at the book value of the minority's share of the assets acquired and liabilities assumed, as was permitted under FRS 22.

Goodwill

Goodwill acquired in a business combination is recognised as an asset and initially measured at cost.

After initial recognition, FRS 103 requires that goodwill be recorded at cost less accumulated impairment charges. Goodwill is no longer amortised, as previously required under FRS 22, but instead is subject to impairment testing annually and when there are impairment indicators. The revised FRS 36 also requires a more rigorous impairment test to be applied.

Negative goodwill

FRS 103 refers to "excess of acquirer's interest in the net fair values of acquiree's identifiable assets, liabilities and contingent liabilities over cost" rather than the term "negative goodwill". This change in terminology reflects the change in accounting requirements under the new standard where the acquirer must:

- reassess the identification and measurement of identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the business combination; and
- recognise any remaining excess in profit or loss immediately on acquisition.

Intangible assets

Companies are required to recognise intangible assets separately from goodwill even under the current standard. However, in practice, many companies continue to include intangible assets acquired in a business combination within goodwill on the basis that it is difficult for most intangible assets to meet the 'identifiability and separability criteria'. The new standard provides a more definitive basis for identifying and recognising intangible assets separately from goodwill:

- Intangible assets can be identifiable through contractual or other legal rights, even though they may be inseparable from other assets;
- The probability of future benefits to be derived from such intangible assets is reflected in the fair value measurement and therefore will always be satisfied for intangibles acquired in a business combination; and
- The rebuttable assumption is that the fair value of an intangible asset can normally be measured with sufficient reliability for it to be recognised separately from goodwill.

Contingent liabilities

An acquirer must recognise the acquiree's contingent liabilities at fair value on acquisition. This treatment differs from the previous requirements in FRS 22, under which contingent liabilities were included within the amount recognised as goodwill.

After initial recognition, if the provision required under FRS 37 *Provisions, Contingent Liabilities and Contingent Assets* is higher than the fair value recorded on acquisition, the liability is increased accordingly. If after acquisition the provision required by FRS 37 is lower than the amount recorded on acquisition, the liability is maintained at the amount recorded on acquisition and decreased only for amortisation or upon settlement.

Liabilities triggered by business combination

A payment that an acquiree is contractually required to make in the event of a business combination (e.g., a so–called 'golden parachute') is a contingent liability of that acquiree. The business combination causes that contingent liability to become probable. Therefore a contractual liability contingent on the business combination should be recognised as part of purchase accounting on acquisition. FRS 22 did not include any guidance on liabilities triggered by a business combination and practice in this area had been varied.

Restructuring

FRS 103 allows restructuring liabilities to be recognised on acquisition *only* when they represent a liability recognised by the *acquiree* at the acquisition date under FRS 37. An acquiree's restructuring plan that is conditional upon it being acquired is not, immediately before the business combination, a present obligation of the acquiree nor is it a contingent liability. Therefore, under FRS 103, such a restructuring provision would not be recognised as an assumed liability (or a cost of the acquisition). FRS 22 allowed restructuring liabilities to be recognised as part of the cost of acquisition if certain criteria were met.

Initial accounting determined on a provisional basis

Sometimes the initial accounting for a business combination can be determined only on a provisional basis at the end of the accounting period in which the business combination occurred. In such cases, subsequent adjustments to the fair values of identifiable assets, liabilities and contingent liabilities or to the cost of acquisition are recorded in goodwill. FRS 103 limits the period for goodwill adjustment to twelve months from the date of the acquisition. Under FRS 22, subsequent changes were allocated to goodwill if they occurred within the first full annual reporting period after the acquisition.

Disclosure requirements

FRS 103 introduces new disclosures in addition to those required by FRS 22. The rationale for the additional disclosure is to enable users to evaluate:

- the nature and financial effect of business combinations occurring during the reporting period and after the balance sheet date;
- the financial effects of gains, losses, error corrections and other adjustments recognised in the reporting period that relate to business combinations; and
- changes in the carrying amount of goodwill during the reporting period.

The main additional disclosure requirements include:

- The amounts recognised at the acquisition date and the carrying amounts immediately before the combination – for each class of the acquiree's assets, liabilities and contingent liabilities;
- A description of the factors that contributed to a cost that results in the recognition of goodwill or "negative goodwill"; and
- The revenue and profit or loss of the combined entity as though the business combination had occurred at the beginning of the financial period.

Revised FRS 36 *Impairment*

Frequency of impairment tests

Previously, impairment testing was required only if a triggering event indicated that impairment might have occurred. Under revised FRS 36, an annual test is required for certain assets including:

- goodwill acquired in a business combination – goodwill must be tested for impairment annually and at any point during the year when an indicator of impairment exists; and
- intangible assets with an indefinite useful life and intangible assets not yet available for use – the recoverable amount of these assets must be measured annually, as well as whenever there is any indication that they may be impaired.

With respect to cash–generating units that include intangible assets with an indefinite useful life and/or to which goodwill has been allocated, the most recent calculation of recoverable amount made in a preceding reporting period *may* be used, provided that certain criteria are met. These criteria include that the composition of the cash–generating units did not change substantially, that the recoverable amount was substantially higher than the carrying amount and that an analysis has been made in order to evaluate the likelihood that the current recoverable amount would be less than the carrying amount.

Cash-generating units - transfer pricing

If internal transfer pricing affects the cash inflows generated by any asset or cash–generating unit, the revised standard requires the entity to use management's best estimate of future prices that could be achieved in arm's–length transactions. These arm's–length prices should be used, instead of the internal transfer prices, to estimate:

- the future cash inflows used to determine the asset's or cash–generating unit's value in use; and
- the future cash outflows used to determine the value in use of other assets or cash–generating units affected by the internal transfer pricing.

Allocating goodwill to cash-generating unit

The revised FRS 36 clarifies that goodwill should be allocated to the acquirer's cash–generating unit (or group of cash–generating units) that are expected to benefit from the synergies of the business combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units. It also clarifies that the initial allocation has to be done from the acquisition date and must be completed before the end of the first annual reporting period beginning after the acquisition date. Furthermore, if an entity disposes of an operation within a cash–generating unit (or group of cash–generating units) to which goodwill has been allocated, all or a portion of the goodwill shall be allocated to the carrying amount of the operation when calculating gain or loss on disposal.

Testing cash-generating units with goodwill for impairment

Where minority interest exists, the revised FRS 36 requires the carrying amount of a unit to be adjusted by grossing up the carrying amount of goodwill allocated to the unit in order to consider the goodwill attributable to the minority interest. This adjusted carrying amount is then compared with the recoverable amount of the unit for impairment testing purposes. However, goodwill is not measured in the financial statements at a grossed–up amount.

Reversal of goodwill impairment losses

Reversal of impairment losses for goodwill is now prohibited.

Disclosure requirements

The revised FRS 36 introduces new disclosure requirements that are much more extensive than those required previously. The main additional requirements include:

- For each cash–generating unit where significant portions of goodwill and intangible assets with indefinite useful lives are allocated, the reporting entity must disclose the key assumptions used to measure the recoverable amounts.
- Where non–significant portions of goodwill and/or intangible assets with indefinite useful lives are allocated to multiple cash–generating units this fact must be disclosed, together with the aggregated carrying amount of goodwill and/or intangible assets with indefinite useful lives allocated to those units.
- Disclosure of specified information when a reasonably possible change in a key assumption would cause the unit's carrying amount to exceed its recoverable amount.

Revised FRS 38 *Intangible Assets*

Definition of an intangible asset

The revisions to FRS 38 clarify the identifiability criterion in the definition of an intangible asset. Previously, FRS 38 stated that separability was a sufficient indication, but not a necessary condition, for identifiability. The revised standard considers an intangible asset to be identifiable if it is separable or arises from contractual or legal rights.

FRS 103 (Illustrative Example) has examples of items acquired in a business combination that meet the definition of an intangible asset. Some examples include trademarks, newspaper mastheads, customer lists, customers' contracts and related customer relationships. Customer relationships may qualify for recognition if exchange transactions for similar relationships provide evidence of control and of identifiability (i.e. through separability), even if they do not arise from contractual or legal rights.

As the definition of an intangible asset does not depend upon the way it is acquired, these items generally can be assumed to meet the definition of an intangible asset when they are acquired individually (i.e., outside a business combination). However, recognition of these intangible assets is still dependent on meeting the other recognition criteria.

Recognition criteria

The revised FRS 38 states that the probability of future economic benefits to be derived from intangibles acquired separately or in a business combination will always be satisfied. These changes do not affect the recognition criteria for internally generated intangibles.

Useful life

The rebuttable presumption that the useful life of an intangible asset will not exceed 20 years has been removed from FRS 38. An entity is now required to determine whether the useful life of an intangible is finite or indefinite:

- Intangibles with *indefinite* useful lives must be tested for impairment at least annually, but these intangibles are not amortised.
- Intangibles with *finite* useful lives are amortised and must be tested for impairment under the general rules of FRS 36 (i.e. on the occurrence of a triggering event). There is no limit to the length of finite useful lives; however, the revised standard provides additional guidance on determining useful lives (e.g., for intangibles that arise from contractual or legal rights). The requirement to test intangible assets with a useful life exceeding 20 years for impairment annually has been removed.

Disclosures

The revised FRS 38 requires the following additional disclosures:

- the carrying amounts of intangible assets which are assessed to have an indefinite useful life together with reasons supporting this assessment; and
- comparative information relating to the reconciliation of the carrying amount of intangible assets at the beginning and end of the period.

Transitional provisions

Implementation dates

Except for the provisions relating to early adoption, FRS 103 should be applied to the accounting for business combinations for annual periods beginning on or after 1 July 2004 (effective date). FRS 103 should be applied **prospectively** from the effective date as follows:

How existing goodwill is treated when first adopting the standard

- *Existing goodwill at the effective date* –Where goodwill was previously capitalised and amortised, the carrying amount of this goodwill as at the effective date should be frozen and no longer amortised. This goodwill should be tested for impairment in accordance with revised FRS 36 from the effective date.
- *Existing negative goodwill at the effective date* –Where negative goodwill was previously recognised on the balance sheet, the carrying amount of the negative goodwill should be eliminated from the balance sheet via a corresponding credit to opening accumulated profits.
- Existing intangible assets acquired in a business combination that do not meet the recognition criteria under the revised FRS 38 should be reclassified as goodwill.

Early adoption of changes

Companies are allowed under FRS 103.85 to apply FRS 103 to business combinations occurring from any date before the effective date, provided:

- the valuations and other information needed to apply FRS 103 to past business combinations were obtained **at the time** those business combinations were initially accounted for; and
- the company also applies revised FRS 36 and FRS 38 prospectively **from that same date**, and the valuations and other information needed to apply those standards from that date were **previously obtained** by the company so that there would be no need to determine estimates at a prior date.

The pre–conditions to adopting FRS 103 before its effective date are stringent. Valuation and other information needed to apply FRS 103 and the revised FRS 36 and FRS 38 should be obtained **at the point of acquisition**. There should not be any need to use estimates or apply the benefit of hindsight. Valuations and other information required at the point of acquisition include, but are not limited to, the following:

- Valuation of each intangible asset that meets the recognition criteria in the revised FRS 38;
- Information for impairment testing of goodwill and intangible assets for periods subsequent to acquisition date; and
- Information and valuation of all contingent liabilities.

It would be difficult for a business combination that occurred more than 12 months ago to qualify as the use of estimate or hindsight is prohibited. The longer the period since acquisition, the more difficult it would be to remove the use of hindsight and meet the conditions to early adopt the standard.

Example 1 on page 10 illustrates how a company applies FRS 103 to business combinations occurring before its effective date.

Differences between FRS 103 and the international standard

FRS 103 and IFRS 3 are the same except for the different implementation dates and transitional provisions:

- FRS 103 is effective for **annual financial periods** beginning on or after **1 July 2004**; whereas
- IFRS 3 is effective for business combinations for which the **agreement date** is on or after **31 March 2004**.

Example 1 - To illustrate how a company applies FRS 103 to business combinations occurring before the effective date of the standard.

Company A's accounting period is from 1 January to 31 December. Company A entered into a business combination agreement in January 2004, where goodwill was determined to be $50 million and intellectual property rights $120 million.

Prior to adoption of FRS 103, Company A amortised goodwill and intellectual property rights over their estimated useful lives of 20 years under FRS 22 and FRS 38 respectively. In August 2003, Company A entered into another business combination agreement, which gave rise to goodwill of $30 million.

Company A has collated the valuation and other information needed to apply the revised standards for the January 2004 acquisition, but not for the August 2003 acquisition.

For the financial year ended 31 December 2003, the goodwill resulting from the August 2003 business combination had been accounted for under FRS 22. Amortisation of goodwill for the year ended 31 December 2003 had been charged to the profit and loss account.

(A) Early adoption not elected

For the financial year ending 31 December 2004, the goodwill and intellectual property rights resulting from the August 2003 and January 2004 business combinations will be accounted for under FRS 22 and FRS 38 respectively, similar to the accounting treatment followed for the year ended 31 December 2003.

For the financial year ending 31 December 2005, Company A will have to adopt the revised standards:

- Goodwill that had been amortised up to 31 December 2004 will be frozen and amortisation will cease. Instead, impairment testing under the revised FRS 36 will be carried out.
- Useful life of the intellectual property rights will be reassessed under the revised FRS 38. Any changes resulting from this reassessment should be accounted for as a change in accounting estimate, i.e. recognised prospectively in the profit and loss account.

Comparatives for 2004 in the 2005 financial statements should not be restated.

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(B) Early adoption elected

If Company A elects to adopt the FRS 103 before its effective date, it should first assess whether it satisfies the two conditions to all its business combinations prior to 1 January 2005. In this case, since the conditions for retrospective application are met only for the business combination in January 2004, Company A is only able to early adopt FRS 103 for the period from 1 January to **31 December 2004** onwards:

- Apply the FRS 103 to recompute goodwill for the business combination in January 2004. This goodwill will not be amortised, but will be subject to impairment testing. Information required for impairment testing will be needed from January 2004 onwards.
- Freeze the amount of goodwill (but no recomputation is necessary) arising from the business combination in August 2003, based on its carrying amount at 1 January 2004. This goodwill will be subject to impairment testing from 1 January 2004.
- Account for the intellectual property rights acquired in the business combination in January 2004 under the revised FRS 38. Accordingly, Company A will reassess the useful lives of the intellectual property rights. If, for example, Company A determines that the intellectual property rights have an indefinite useful life and thus need not be amortised under the revised FRS 38, no amortisation will be necessary. The intangible asset will be tested for impairment.

Comparatives for 2003 in the 2004 financial statements should not be restated, since the revised standards are implemented from 1 January 2004.

Accounting for business combinations with agreement dated on or after 1 July 2004, but before the first annual financial period beginning from 1 July 2004

For companies with year–ends other than 30 June, transitional provisions in FRS 103 do not cover the accounting treatment for goodwill arising on business combinations with agreements dated on or after 1 July 2004 but before the first annual financial period beginning from 1 July 2004 (post 1 July combinations). The issue arises because FRS 103.79 to FRS 103.84 only cover business combinations with agreements dated before 1 July 2004.

For these companies that do not early adopt the standard, KPMG's view is that the standard is intended to be implemented on a financial year basis. In spite of the way FRS 103.79 to FRS 103.84 is written, the transitional provisions should also cover "post 1 July combinations".

Accounting for goodwill previously written off against reserves when the investment is disposed/impaired

Where goodwill had previously been taken directly to equity, the amount should not be recycled to the profit and loss account on disposal of the business to which the goodwill relates or on impairment of the cash–generating unit to which the goodwill relates.

The above provision has not been explicitly stated for negative goodwill, we believe that the intention was to clarify that both positive and negative goodwill that had previously been recognised directly in equity should not be recycled to profit or loss when an entity disposed of the investment or when the entity impairs the cash–generating unit to which the goodwill relates.

If a company had previously adopted a policy of recycling goodwill to the profit and loss account on disposal/impairment, this change in policy should be applied **prospectively**. However, if a company had early adopted FRS 103, the accounting policy change should also be adopted from that same earlier date.

FRS 105 *Non-current Assets Held for Sale and Discontinued Operations*

Implementation dates

FRS 105 should be applied prospectively for annual periods beginning on or after 1 January 2005. Entities are permitted to apply the standard to all non–current assets (or disposal groups) held for sale and discontinued operations from any date before 1 January 2005, provided that the valuations and other information needed to apply the standard were obtained at the time the original events were accounted for.

FRS 105 will replace FRS 35 *Discontinuing Operations* when it becomes effective.

Objective and scope

The objective of FRS 105 is to specify the accounting for assets (and disposal groups) held for sale and the presentation and disclosure of discontinued operations.

The **classification and presentation** requirements of FRS 105 apply to **all** non–current assets and disposal groups.

The **measurement** requirements apply to all disposal groups and to all recognised non–current assets **except for**:

- financial assets;
- deferred tax assets;
- assets related to employee benefits and insurance contracts; and
- certain assets whose subsequent measurement is based on fair value.

Non–current Assets held for Sale

Concept of a disposal group

A disposal group is a group of assets to be disposed of together, by sale or otherwise, in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. A subsidiary held for sale is an example of a disposal group.

Classification as held for sale

A **new** classification of assets as 'assets held for sale' is introduced. A non–current asset (or disposal group) is classified as held for sale if:

- the asset (or disposal group) is available for **immediate sale** in its present condition; and
- the sale is highly **probable.**

For the sale to be highly probable, management must be committed to a plan to sell the asset and the asset must be actively marketed at a reasonable price. The sale should also be expected to be completed **within one year** from the date of the classification as held for sale.

A non–current asset (or disposal group) that is to be abandoned should not be classified as held for sale. The rationale is that such assets are held for use before being abandoned and therefore the carrying amount of such an asset will be recovered principally through continuing use and not through sale.

Measurement of asset held for sale including recognition of impairment losses and reversals

Key measurement and recognition requirements:

- Immediately before its classification as held for sale, a non–current asset (or a group) should be measured in accordance with the applicable standard (e.g. revaluation, impairment etc). Any resulting gain or loss is recognised in accordance with the relevant standard.
- On initial classification as held for sale, the non–current asset (or disposal group) is re–measured at the lower of carrying amount and fair value less costs to sell. Any loss as a result of re–measurement is included in the profit and loss account regardless of whether the asset is (or the disposal group includes assets that are) previously measured based on a revalued amount.
- Once classified as an asset held for sale (or disposal group), depreciation should also cease. This is different from the requirement of FRS 16 *Property, Plant and Equipment* where an asset has to be depreciated even when it is idle.
- At every subsequent period end, the non–current asset (or disposal group) is re–measured at fair value less costs to sell. Any loss as a result of re–measurement is included in the profit and loss account. Any re–measurement upwards is subject to a gain recognition limit, which is the cumulative amount of impairment losses recognised either in accordance with FRS 105 or previously in accordance with FRS 36.

Additional considerations relating to a disposal group

On each subsequent re–measurement of a disposal group, the carrying amount of any asset or liability that is not within the scope of FRS 105 is first re–measured in accordance with the applicable standard. Any gain or loss is recognised in accordance with the relevant standard.

Thereafter, the whole disposal group is measured at the fair value less cost to sell. This resulting gain or loss is then allocated to the non–current assets in the group that are within the scope of FRS 105 in the order of allocation as required by FRS 36 (i.e., in the case of losses, first to goodwill and then to other assets on a pro–rata basis).

Assets acquired exclusively with a view to its subsequent disposal

A non–current asset (or a disposal group) acquired exclusively with a view to its subsequent disposal is classified as held for sale, if it meets the held for sale criteria or if it is **highly probable** that it will meet those criteria, within a short period (usually three months) following the acquisition.

A non–current asset acquired (not in a business combination) exclusively with a view to its subsequent disposal would first be carried at cost on acquisition and almost immediately be re–measured to the lower of cost and fair value less costs to sell. Any loss on re–measurement is taken to the profit and loss account.

For non–current assets (or disposal groups) acquired in a business combination that meet the criteria as held for sale should be measured on initial recognition at the fair value less costs to sell rather than fair value.

FRS 105 has removed the present exemption from consolidation of a subsidiary that is acquired and held exclusively with a view to disposal (in the revised FRS 27 *Consolidated and Separate Financial Statements*). As a result, such **subsidiaries must be consolidated** but are classified, measured and presented as disposal groups or held for sale if they meet the criteria.

A newly acquired subsidiary that is classified as held for sale is exempted from certain disclosures under FRS 105.

Reclassification as not held for sale

If the criteria for classification as held for sale are no longer met, the related non–current assets are measured at the lower of their carrying amounts had the assets not been classified as held for sale and their recoverable amount.

Presentation and disclosure requirements

The key presentation and disclosure requirements are:

- separate presentation on the face of the balance sheet of the total of each of:
  - non–current assets classified as held for sale (whether separately or as part of a disposal group); and
  - liabilities classified as held for sale as part of a disposal group;
- analysis of the above into major classes of assets and liabilities, except where the disposal group is a newly acquired subsidiary that is classified as held for sale on its acquisition;
- separate presentation of amounts recognised directly in equity relating to non–current assets (or disposal groups) classified as held for sale;
- the gain or loss arising from reclassification or subsequent measurement of non–current asset (or disposal groups) classified as held for sale; and
- description of the non–current assets (or disposal groups) classified as held for sale and the reasons for reclassification.

Classification in prior periods should not be revised when the non–current asset (or disposal group) is initially classified as held for sale in the current period.

Discontinued Operations

Classification as discontinued operations

FRS 105 requires classification as a discontinued operation at the earlier of the date that:

- the entity actually disposed of the operation; or
- the operation meets the criteria to be classified as held for sale.

This is different from FRS 35 that requires the classification of an operation as discontinuing at the earlier of (a) the entity entering into a binding sale agreement or (b) the board of directors approving and announcing the formal disposal plan.

FRS 105 limits discontinued operations to a component of an entity that:

- represents a separate major line of business or geographical area of operations (or is part of a coordinated single plan to dispose of such a component); or
- is a subsidiary acquired exclusively with a view to resale.

The retroactive classification as a discontinued operation is now prohibited when the discontinued criteria are met after the balance sheet date. Instead, disclosures are required in the notes to the financial statements.

Presentation and disclosure requirements

Key presentation and disclosure requirements :

- Separate presentation on the face of the profit and loss account of a single amount relating to discontinued operations;
- Analysis of the single amount either on the face of the profit and loss account or in the notes to the financial statements, showing separately: revenue, expenses, pre–tax profit or loss, related income tax expense, gains and losses on measurement to fair value less costs to sell (and the related income tax expense).
- Net cash flows attributable to the operating, investing and financing activities of discontinued operations.

The above analysis and cash flow information is not required for a newly acquired subsidiary that is classified as held for sale on acquisition.

Comparative information is required and **must be restated each year** so that the comparative information given in respect of discontinued operations includes all operations classified as discontinued at the current balance sheet date.

Development in IFRS

The July 2004 issues of ***IFRS in Brief*** and ***IFRS Briefing Sheets*** summarise the IASB discussion paper on accounting standards for SMEs, and recent draft interpretations, including the one on consolidation of special purpose entities.

The IASB has finally announced the commencement of the project to develop accounting standards for SMEs. Questions being actively considered by the IASB are:

- **What kind of entities / companies would qualify as an SME?**
  The proposal is to link the definition to 'public accountability' and it is clear that the 'size criteria' will not be used.
- **What would be the appropriate approach to develop accounting standards for SMEs?**
  The preliminary view is that the approach will be based on fundamental concepts. Whilst it is likely that disclosure and presentation modifications will be justified, there would be a rebuttable presumption that no modifications would be made to recognition and measurement principles.

The August 2004 issues of ***IFRS in Brief*** and ***IFRS Briefing Sheets*** carry news of the latest exposure drafts proposing amendments to the standards on financial instruments.

Current status of IAS 32 and IAS 39:

- The latest revision, issued in July 2004, allows 'portfolio hedging' or 'macro hedging'. This revision is effective from 1 January 2005.
- Proposal from two exposure drafts are expected to be effective from 1 January 2005.
  - One is on 'the fair value option', which is a direct response to concerns expressed by the regulators that the fair value option might be used inappropriately. The exposure draft proposes to limit the financial assets and liabilities to which the option may be applied, while preserving the key benefits of the option.
  - The other is on limited amendments to FRS 39 that would apply when entities first adopt FRS 39. It would allow, but not require, entities to adopt an approach to transition that is easier to implement than that in the current version of FRS 39.
- There are three other exposure drafts proposing amendments to disclosure, cash flow hedge accounting for forecast intragroup transactions and financial guarantee contracts and credit insurance, which are not expected to be effective until January 2006 at the earliest.

In the next issue

In the next issue of Financial Reporting Matters we will discuss accounting for share options, insurance contracts and consolidate the position relating to financial instruments. In the meantime, you may contact Tham Sai Choy at +65 6213 2500 or Esther Bay at +65 6213 2003 to discuss matters relating to share-based payment transactions.

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